PERFORMANCE AUDIT

INDUSTRIAL COMMISSION OF ARIZONA

Report to the Arizona Legislature
By the Auditor General
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DOUGLAS R. NORTON, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
DEPUTY AUDITOR GENERAL

June 7, 1995

Members of the Arizona Legislature

The Honorable Fife Symington, Governor

Ms. Gay Conrad Kruglick, Chairman
Industrial Commission of Arizona

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Industrial Commission of Arizona. This report is in response to a May 5, 1993, resolution of the Joint Legislative Audit Committee.

We found the Industrial Commission of Arizona (ICA) to be generally well-managed and adequately performing its responsibilities. However, we also found ICA can strengthen its workplace safety and health enforcement by focusing its efforts on those employers with the most hazardous worksites and by more appropriately penalizing violators. In addition, Arizona can increase its emphasis on accident prevention by requiring accident prevention programs for hazardous industries. These programs have been found nationally to increase safety and lessen costs to business. Finally, ICA can improve its timeliness in resolving protested claims, and can improve its enforcement efforts against uninsured businesses.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on June 8.

Sincerely,

Douglas R. Norton
Auditor General

2910 NORTH 44TH STREET • SUITE 410 • PHOENIX, ARIZONA 85018 • (602) 553-0333 • FAX (602) 553-0051

SUMMARY

The Office of the Auditor General has conducted a performance audit and Sunset review of the Industrial Commission of Arizona pursuant to a May 5, 1993, resolution of the Joint Legislative Audit Committee. The audit was conducted under the authority vested in the Auditor General by Arizona Revised Statutes (A.R.S.) §§41-2951 through 41-2957.

The Industrial Commission of Arizona (ICA) was established in 1925 to administer and regulate workers' compensation, ensure workplace safety, license employment agencies, and generally administer and enforce all laws for the protection of employee life, health, safety, and welfare not specifically delegated to others. The agency is overseen by a five-member commission responsible for promulgating rules and regulations, commuting workers' compensation awards to a lump sum, licensing self-insured employers for workers' compensation, and hiring the ICA Director. In fiscal year 1993-94, ICA had 290 employees, and expended $13.6 million for agency operations and $18.6 million in non-appropriated monies for expenses of injured employees.

We found ICA to be generally well-managed and adequately performing its responsibilities. Our audit proposes consideration of legislation requiring employer-operated accident prevention programs and provides recommendations for improvement in three ICA program areas.

ICA Can Strengthen Workplace Safety and Health Enforcement (See pages 5 through 14)

The Commission can improve its enforcement of workplace safety and health requirements. Since ICA can inspect only a small percentage of Arizona's approximately 97,000 employers each year, it is important that they focus their efforts on those with the most hazardous worksites. However, we found that ICA's current selection methods do not adequately target its limited inspection resources to those worksites most likely to have serious safety and health problems. The Commission could better target inspections if it incorporated employer-specific violation and injury data into its inspection selection process. Information concerning employers' previous violation history and injury rates has been found by the U. S. General Accounting Office (GAO) and others to be a good indicator of problem worksites.

In addition, even when inspections occur and violations are found, ICA does not adequately penalize violators. Although penalties are designed to discourage employers from violating occupational safety and health laws, our review of ICA inspection and penalty data showed that penalties are often low. In calendar year 1993, ICA's average

cited penalties for serious safety and health violations were $784 and $775, respectively. These penalties were on average more than $300 under the penalties cited by the federal Occupational Safety and Health Administration (OSHA) and the other states we reviewed. Although average penalty amounts increased during our audit in 1994, ICA's penalties for serious safety violations continued to lag behind federal OSHA and other states in OSHA Region IX (California, Nevada, and Hawaii). In addition, we found that the majority of ICA's penalties are subsequently reduced during informal conferences with employers.

Greater Emphasis on Accident Prevention Needed (See pages 15 through 18)

Although ICA can maximize the deterrent effect of its enforcement efforts by better targeting inspections and issuing stiffer penalties, employers need to be given more responsibility for worker safety and health. With a ratio of 1 inspector to approximately 4,200 employers, ICA cannot directly regulate all Arizona worksites. Arizona should require employers to accept more of their responsibility to identify and correct workplace hazards. This could be accomplished by adopting legislation requiring employers to establish accident prevention programs, as is currently required by at least 11 other states. According to a recent study commissioned by the federal Occupational Safety and Health Administration, these programs are effective both in terms of reducing employee injuries and associated employer costs. The study indicates that for every dollar spent on accident prevention programs, employers would save an estimated $3.50 to $5. ICA has existing resources that could be used to provide consultation and training assistance to employers in developing such programs.

ICA Can Improve Its Workers' Compensation Adjudication System (See pages 19 through 24)

The Commission's growing caseload limits its ability to resolve protests involving workers' compensation claims in a timely fashion. Our review of 100 protested claims revealed that it took ICA a median time of 126 days to hear cases after protests were scheduled for hearing. However, prior to July 26, 1993, the informal policy was to hear cases 60 days after hearings were scheduled and after that date a 90-day standard was in effect. Delays in resolving protested claims appear to be due, at least in part, to the growing number of protests. The number of protests referred to ICA's Administrative Law Judge (ALJ) Division increased from 8,406 in fiscal year 1991-92 to 10,301 in fiscal year 1993-94, and is

expected to continue rising. ICA could reduce the number of formal hearings by using in-house prehearing settlement conferences or conciliation processes to encourage parties to settle cases prior to hearing.

Resolution of workers' compensation claim disputes is also delayed by the need to hold subsequent hearings, most often to obtain medical testimony. Our review of protested claim case files showed that 57 percent of the protests heard by the ALJ Division required at least one subsequent hearing. These subsequent hearings extend the process a median of 54 days, and additional hearings extend it even further. ICA could reduce the number of cases requiring further hearings, and reduce delays in those cases requiring subsequent hearings, by using telephone conferences, medical depositions, or standardized medical reports to gather needed information.

ICA Needs To Improve Enforcement Efforts Against Uninsured Businesses (See pages 25 through 30)

ICA needs to improve its efforts to encourage employer compliance with mandatory workers' compensation insurance requirements. Payments from the Special Fund, established to pay the expenses of injured workers of uninsured employers, have grown 388 percent over the past 10 years and now approach $5 million per year. However, little action is taken against the uninsured employers who are legally responsible for these payments. ICA recovers less than 20 percent of the payments made from the Special Fund, and does not consistently assess penalties against employers for not having insurance. In 1 case we reviewed, ICA 3 times waived penalties for an employer who had more than 20 no-insurance violations. In addition, we found there is a backlog in handling no-insurance cases. ICA's Legal Division has approximately 450 cases awaiting initial action and approximately 110 cases that should have been referred to outside collectors.

Greater emphasis on identifying uninsured employers is also needed. Our 1984 audit recommended that the Commission take steps to identify uninsured employers before workers' compensation claims are received. While ICA has taken some steps in response to our recommendation, more could be done to proactively identify uninsured employers. The Commission could: 1) develop a better database to monitor compliance with workers' compensation insurance requirements and 2) work with other agencies to assist with compliance monitoring. For example, the Registrar of Contractors now requires proof of workers' compensation insurance before issuing or renewing a contractor license.

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit and Sunset review of the Industrial Commission of Arizona (ICA), pursuant to a May 5, 1993, resolution of the Joint Legislative Audit Committee. This audit was conducted under the authority vested in the Auditor General by A.R.S. §§41-2951 through 41-2957.

Originally created in 1925, the Industrial Commission was established to administer and regulate workers' compensation, ensure safety in the workplace, license employment agencies, and generally administer and enforce all laws for the protection of life, health, safety, and welfare of employees, where such duty is not specifically delegated to others.

While the purpose of the agency has remained unchanged, the Industrial Commission was substantially reorganized in 1968. The original Commission, which functioned as a state-owned insurance company with authority to regulate all other insurers providing workers' compensation coverage in the State, was restructured when legislation created a separate agency, the State Compensation Fund, to provide workers' compensation insurance. In addition, the Arizona State Department of Insurance assumed the duty of licensing workers' compensation insurance carriers.

Importance of ICA

ICA oversees a number of programs that help regulate and protect Arizona's workers. Some examples of important responsibilities include the following:

Workplace safety — One of the ICA's functions is to regulate workplace safety. ICA's Arizona Division of Occupational Safety and Health (ADOSH) administers Arizona's occupational and safety laws to ensure workplace safety. As of November 1993, Arizona had approximately 97,000 employers and 1.6 million employees who were under ICA's regulatory authority.

In calendar year 1992, the most recent year for which data were available, there were 8.6 occupational injuries and illnesses resulting in 62.5 lost workdays reported per 100 full-time workers. The construction industry represents the highest injury category with 16 occupational injuries and illnesses per 100 full-time workers in calendar year 1992.

Workers' compensation — Statutes require all workers' compensation claims to be filed with ICA. In addition, ICA adjudicates cases regarding disputed claims. In fiscal year 1993-94, ICA received 180,050 claims and forwarded 10,301 disputed claim cases to be adjudicated by the Administrative Law Judge (ALJ) Division. As part of our review, we

examined cases where benefits were decided without the need of adjudication and found it took an average of 16 days to process these undisputed claims, within the mandated 21 days.

Organization and Personnel

The agency is overseen by a five-member commission appointed by the Governor. The Commission is responsible for promulgating rules and regulations, approving self-insurers for workers' compensation, determining whether to commute individual workers' compensation benefits to a lump sum settlement, and hiring the ICA Director. Under direction of the Commission, the Director administers the various agency activities.

ICA is organized into seven divisions and a Director's office to carry out its statutory functions, as shown on page 3.

Budget

ICA receives no funding from the State General Fund. The Commission utilizes two major funds: the Administrative Fund and the Special Fund. These funds are supported by a surcharge on workers' compensation insurance premiums paid by Arizona employers. Tax rates vary depending on financial needs. The Administrative Fund supports most agency operations. The tax rate for this fund, which can range from 0 to 3 percent of premiums, is currently set at 1.25 percent. The Administrative Fund budget is appropriated by the Legislature. For fiscal year 1993-94 ICA expended $13,622,274 from the Administrative Fund, federal, and other funds.

The Special Fund is used to provide benefits to injured workers whose employers did not obtain workers' compensation insurance. The Special Fund budget is not appropriated by the Legislature. In fiscal year 1993-94, Special Fund Expenditures totaled $18.6 million. The Special Fund surcharge, which can vary from 0 to 1.5 percent of premiums, is currently 0 percent. ICA uses an investment board to advise the Commission on surcharge rates. The Commission then annually sets the surcharge levels for both funds. Based on actuarial analyses and a relatively strong investment performance, the Commission determined that a surcharge was not needed for the Special Fund in 1995. The Special Fund's total assets are valued at approximately $200 million.

Statutes mandate that fines and penalties collected through the OSHA program be deposited in the State General Fund. In fiscal year 1993, over $1 million was remitted.

Industrial Commission of Arizona

Arizona Division of Occupational Safety and Health (ADOSH) (60 FTEs)[a]

Administers Arizona's occupational safety and health laws.

Claims Division (83 FTEs)

Processes all industrial insurance claims filed in the State.

Administrative Law Judge Division (ALJ) (54 FTEs)

Adjudicates disputed workers' compensation claims as well as contested citations, and appeals Cease and Desist orders and penalty assessments from ADOSH and Labor divisions.

Special Fund Division (15 FTEs)

Processes and provides benefits for all claims where the injured worker's employer failed to provide worker's compensation insurance. Medical compensation and rehabilitation benefits are provided. In addition, indemnity benefits are provided in some types of second-injury cases.

Legal Division (15 FTEs)

Represents all ICA divisions in litigation involving enforcement and collection of penalties. Also provides legal opinions and advice to Director and Commission concerning policy and procedural matters.

Labor Division (14 FTEs)

Administers statutes relating to wage complaint disputes. Also licenses and regulates private employment agencies and enforces child labor law statutes and regulations.

Administration Division and Director's Office (44 FTEs)

Provides support to the entire ICA including personnel, accounting, and computer services. The Director oversees all agency operations.

(a) All FTE numbers are from fiscal year 1993-94.

Audit Scope

Our review found that ICA is generally well-managed and sufficiently performing its duties. Our findings and recommendations address four areas.

- The need to improve targeting and enforcement of businesses violating workplace safety and health regulations.
- The need to require employer-operated accident prevention programs.
- The need to more quickly resolve disputed workers' compensation cases.
- The need to improve enforcement of mandatory workers' compensation insurance requirements.

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the Commission, Director, and staff of the Industrial Commission of Arizona for their cooperation and assistance throughout the audit.

FINDING I

ICA CAN STRENGTHEN WORKPLACE SAFETY AND HEALTH ENFORCEMENT

The Industrial Commission of Arizona (ICA) can improve its enforcement of worker safety and health requirements. ICA inspections identify fewer employers with serious violations than programs in several other states, suggesting that it could more effectively target its inspections on those employers most likely to have workplace safety and health violations. The Commission can also increase the deterrent effect of the penalties it imposes for violations. ICA's average penalties for serious safety and health violations in 1993 and 1994 were generally lower (sometimes several hundred dollars lower) than those assessed by the federal government and other states we reviewed. In addition, the majority of ICA's penalties are subsequently reduced during informal conferences with the employers.

ICA's Arizona Division of Occupational Safety and Health (ADOSH) has primary responsibility for the enforcement of worker safety and health statutes in the State. The federal Occupational Safety and Health Administration (OSHA) delegates this responsibility to states that establish laws similar to theirs. ADOSH has 31 enforcement staff, most of whom conduct safety and health inspections of Arizona businesses and public entities. Employers are required to comply with various health and safety standards. If found out of compliance, they may be subject to enforcement action that typically involves a penalty. In calendar year 1993, ADOSH conducted 1,952 inspections, found 2,931 minor and 833 major violations, and issued penalties totaling $827,048.

ICA Can Better Target Safety and Health Inspections

The Commission can improve its targeting of compliance inspections. Since ICA can inspect only a small percentage of Arizona employers each year, it is critical that limited inspection resources be focused on those employers most likely to have problems that could result in employee injuries and illnesses. In addition, ICA may be able to increase the number of inspections performed by making greater use of partial inspections.

Targeting is key to the effectiveness of inspections — ICA cannot reasonably inspect all employers in Arizona and it does not need to. With an effective targeting strategy, the Commission can focus its inspection efforts on those employers who are likely to have serious workplace safety and health problems. In this way, ICA can have a greater impact on eliminating workplace hazards.

ICA has 23 inspectors to enforce safety and health standards for more than 97,000 employers with approximately 1.6 million workers. This equates to 1 compliance officer for over 4,200 employers in Arizona. As a result, most employers are rarely inspected, and even employers in high-hazard industries are inspected infrequently. In calendar year 1993, ICA staff inspected approximately 1,950 (2 percent) of all employers. ICA inspectors annually perform more inspections per inspector than most other states. Furthermore, although ICA focuses its efforts on firms in the high-hazard manufacturing and construction industries (77 percent of all inspections), only 8.2 percent of manufacturing employers and 11.1 percent of construction employers were inspected in 1993.

Employers with the highest risk of injuries and illnesses are not adequately targeted – ICA's current inspection selection methods do not ensure that worksites with the greatest potential safety and health problems are inspected. ICA focuses its inspection efforts on the most hazardous industries. However, because of the large number of businesses within those industries and ICA's limited manpower, ICA needs to direct its efforts to those businesses within the hazardous industries that have a poor track record for safety. Because ICA only targets inspections on hazardous industries instead of problem businesses within those industries, serious violations are uncovered in only 1 out of every 4 inspections, and no violations are identified in more than 40 percent of all inspections performed.

In contrast, several other states we contacted identify safety and health problems more frequently in the inspections they perform. For instance, Oregon's inspection staff identified serious, willful, or repeat violations in 43 percent of all inspections, and found no violations in only 20 percent of the inspections performed. Washington and Minnesota also found problems more frequently with serious, willful, and repeat violations identified in 43 percent and 42 percent of all inspections, respectively.

ICA could improve inspection targeting through use of employer-specific data – ICA's past inspections have focused on the high-hazard construction and manufacturing industries. The Commission continues to devote much of its inspection resources to monitoring workplace safety and health at construction sites. In addition, in October 1992, ICA began targeting employers with 50 or more workers' compensation claims for inspection. While ICA's emphasis on construction inspections appears appropriate, and focusing on employers with numerous workers' compensation claims has led to the identification of more serious violations per inspection, more can be done to target problem employers. We found several problems with ICA's current inspection targeting methods. For instance:

- **History of serious violations not considered** – ICA does not consider the previous violation history of each employer when determining who will receive manufacturing and construction inspections. There may be wide disparity in the violation history of employers, even in the same industry. For example, our review of records concerning 10 masonry contractors showed that the number of serious, willful, and repeat viola-

tions ranged from 0 to 18 during a 3-year period. The United States General Accounting Office (GAO) found that an employer's previous violation history is a good indicator of worksite conditions and should be considered in targeting inspections.

- **Data on injury rates not utilized** — ICA's claim inspections have focused on employers with 50 or more workers' compensation claims in a year. This approach tends to focus inspection efforts on employers with a large number of employees rather than those employers (regardless of how many employees) with the highest injury rates. Furthermore, ICA does not consider information concerning the seriousness, types, and causes of injuries at each worksite when targeting claim inspections. Incorporating this type of data into the selection process would enable ICA to better target inspections on those with the most frequent and severe injuries. A recent study commissioned by federal OSHA found that consideration of worksite-specific injury data could enhance inspection targeting effectiveness. Similarly, a Michigan disability prevention study reported that the past injury experience at a worksite was the most useful predictor of current injuries.

Other states have utilized employer-specific data to increase the effectiveness of inspection targeting efforts. For instance, Oregon targets employers with claims rates that exceed the state average. Their priority inspections include those with the most workers' compensation claims and previous serious violations. Similarly, Washington targets employers based on a variety of data that include: claims history (including seriousness, type, and cause), previous violations, and industry. Minnesota develops inspection targeting lists using individual worksite data, supplementing them with information from OSHA's list of hazardous industries. As mentioned previously, each of these states identify serious, willful, and repeat violations at a much higher rate than Arizona. Officials from these states told us that use of employer-specific data has enabled them to better target problem employers.

Before ICA can incorporate employer-specific data into its inspection selection process, it must improve its recordkeeping and data management. For instance, ICA cannot easily generate information concerning employers' violation histories because it does not maintain a unique identification number for each employer. Additionally, ICA does not routinely analyze or report data regarding the seriousness, causes, and types of injuries reported in workers' compensation claims, which would enable the Commission to precisely target hazards causing injuries at particular worksites. Improved data management and recordkeeping in these areas would provide the information needed to target employers for inspection based on their previous violation history and workers' compensation claim experience.

Greater use of partial inspections would allow staff to perform more inspections — In addition to better targeting inspections, ICA may be able to expand the number of inspections performed by making increased use of partial inspections. These inspections would focus only on specific safety and health problems identified through a review of pertinent

records. For instance, instead of conducting a comprehensive review of hundreds of safety and health requirements, inspectors could limit their review to problems that led to previous violations or injuries, as well as problems found among similar employers. For example, construction inspections could be focused on the four groups of hazards that cause the most construction fatalities and serious injuries.

ICA seldom performs partial inspections as part of its routine monitoring of compliance with workplace safety and health standards. According to agency records, in the 3-year period ended March 31, 1994, ICA conducted 216 partial inspections and 3,571 comprehensive inspections using their inspection targeting approach.

Focused partial inspections take less time to perform. According to an ADOSH supervisor, only a half day or less is needed for partial inspections, whereas comprehensive inspections require a full day or more. As a result, increased use of partial inspections would enable the Commission to inspect more employers with its existing resources. For example, if ICA staff had utilized partial inspections rather than comprehensive inspections in a third of the programmed inspections done in 1993, they could have used the time saved to conduct nearly 300 additional partial inspections.

Federal OSHA established a policy in 1994 requiring use of focused partial inspections to increase the number of construction sites inspected. These inspections are to focus on the four groups of hazards discussed above. A field test of the policy, conducted by OSHA staff in New York, found that focused partial inspections took approximately a third as long as comprehensive inspections, and yet the quality of inspection was not diminished. ICA adopted this policy in October 1994 and has conducted 26 of these focused partial inspections as of April 30, 1995.

Low and Frequently Reduced Penalties Limit the Impact of ICA Enforcement Efforts

Even when inspections are conducted and serious violations are found, ICA penalties often do not send a strong message to violators. Although penalties can deter employers from violating safety and health regulations and, as a result, minimize work-related injuries and illnesses, the deterrent effect of ICA's enforcement activities is hampered by low cited penalties and frequent reductions after citations are issued.

Penalties are an important tool in achieving a safe workplace — Penalties are intended to deter employers from violating occupational safety and health standards designed to reduce workplace hazards. Congressional intent is clear concerning penalties for violations: "*...companies which operate in a reckless manner should be dealt with firmly and effectively*

so that this cause of industrial injury can be eliminated." To enhance the deterrent effect of penalties, the federal and state governments recently approved significant (sevenfold) increases in the maximum penalty amounts for workplace safety and health violations.

ADOSH assesses penalties for violations of safety and health regulations found during workplace inspections. Four types of violations may be cited:

Four Types of Violations

Nonserious

A violation not likely to cause death or serious physical harm to an employee. Penalties are rarely assessed, but these violations carry a statutory maximum of $7,000. For example, a nonserious violation could be for failure to have an ADOSH poster displayed.

Serious

A violation likely to result in death or serious physical harm to an employee. Penalty amounts range up to the statutory maximum of $7,000. Failure to ensure that employees wear fall protection equipment when working at heights is an example of a serious violation.

Repeat

A violation previously found during an inspection of the employer. Penalty amounts range from $200 for a repeat nonserious violation to the statutory maximum of $70,000. Many repeat violations cited are for reoccurrences of nonserious violations.

Willful

Any violation that the employer knew placed employees in danger and did not correct. Penalty amounts range from a minimum of $5,000 to the statutory maximum of $70,000. Willful violations that result in permanent disability or death to an employee carry an additional $25,000 penalty to be paid to survivors.

Factors used in calculating penalties — The method used by ICA to calculate penalties, which was developed by the federal government and is also used by federal OSHA and many other states, is designed to lead to penalty amounts that are often far below the allowable maximum. This method, which is based on federal and state statutes, considers four factors in determining penalty amounts. These factors include the seriousness of the violation, the number of employees an employer has within Arizona, the good faith of an employer, and an employer's previous inspection history.

To illustrate how these factors can lead to penalties that are substantially less than the statutory maximum, consider the following example. In 1993, two demolition employees were throwing lumber off of a roof at an Air Force base when one employee lost his balance and fell 24 feet to the bottom of a concrete loading dock. The employee suffered a broken ankle, elbow, and nose. ICA cited the employer for not requiring employees to wear appropriate safety gear that would have prevented a fall. The employer admitted that management decided against having employees wear the protective equipment in an attempt to "speed up the job." ICA judged the employer to have committed a serious violation which carried a penalty of $2,500. Under federal guidelines they reduced this penalty further:

- To adjust for size (the employer had 15 employees), ICA took off 60 percent, or $1,500.
- To adjust for "good faith," ICA determined that the employer had developed a safety program and took off 15 percent, or $375.
- To adjust for history, ICA took off 10 percent, or $250, because although previously inspected, the employer had no violations.

This resulted in an 85 percent reduction from the $2,500 initial penalty. The employer was issued a $375 citation for this violation of state law.

Issued penalties are low — Although ICA uses the same basic formula to calculate penalty amounts, we found its average penalties for safety and health violations were generally lower than those issued by OSHA and other states. As shown in Table 1 (see page 11), Arizona's penalties for serious violations averaged $300 to $400 less than the average penalties issued by OSHA in 1993. In addition, of the 21 states with workplace safety and health jurisdiction, 13 states had higher average penalties for serious safety violations than Arizona and 16 had higher penalties for health violations in 1993. Finally, Arizona had considerably lower safety violation penalties in 1993 than other states (California, Hawaii, and Nevada) within OSHA Region IX. The average penalty issued by ICA for serious violations increased during the course of our audit. Penalties for serious safety and health violations issued by ICA in 1994 averaged $974 and $1,206 respectively. While ICA's average penalty for serious health violations was comparable to federal OSHA and other states in 1994, their average penalty for serious safety violations continued to lag behind OSHA and other Region IX states.

Table 1

Average Cited Serious Penalties for Arizona, Federal OSHA, Other States with Safety Jurisdiction, and Region IX States Calendar Years 1993 and 1994

Violation Type	Year	Arizona	Federal OSHA	Other States with Safety Jurisdiction	Other Region IX States California	Hawaii	Nevada
Safety	1993	$ 784	$1,092	$ 875	$1,643	$1,655	$1,625
	1994	974	1,136	858	1,605	1,139	2,190
Health	1993	775	1,151	1,018	1,014	894	1,512
	1994	1,206	1,229	1,030	1,258	900	1,969

Source: Federal OSHA, Office of State Programs, for Calendar Years 1993 and 1994.

Arizona's lower average penalty amounts may be due to a variety of factors. Penalties may be lower due to the severity level of serious violations as determined by ICA. As part of the penalty formula, ICA must determine and assign one of six levels of severity for serious violations. Based on that determination, the penalty amount varies from $1,500 to $5,000. The case described on page 10 provides an example of how the severity level may not be appropriately applied, resulting in a lower penalty. For that case, ICA applied a "low severity" level with an associated initial penalty of $2,500; whereas, according to their guidelines, a medium severity level should have been applied because the injured employee was hospitalized. A medium severity level would have resulted in an initial penalty of $3,500.

Differences in average penalty amounts may also be due to variations in inspection frequency, the types of businesses the agency targets for inspection, or how the agencies apply the penalty formula. For instance, if inspections occur infrequently and the businesses have not been inspected within three years, the formula allowance of a 10 percent reduction for a favorable inspection history in the past three years would be applied more often. In addition, although ICA uses the same formula reductions as federal OSHA and other states, considerable discretion is given in their application. As a result, ICA may be giving these reductions more frequently than other states.

Lower penalties do not, however, appear to be related to differences in the size of employers. ICA officials have suggested that the agency has lower average penalties because the State's businesses tend to have fewer employees than those in other states and, therefore, qualify for larger formula discounts. However, the average number of employees

working for Arizona businesses is comparable to the averages for the nation and other states in OSHA Region IX.[1]

Whatever the causes for its lower penalties, ICA could substantially strengthen their penalties by using the statutory maximum of $7,000 as the basis for calculating penalties for serious violations. Currently ICA has administratively set a maximum penalty of $5,000 as the starting point for calculating penalties for serious violations rather than using the maximum allowed by statute of $7,000. Other states have adjusted the penalty structures that they use. For example, North Carolina and Tennessee recently modified their formulas so that gravity-based penalties for serious violations with a high probability of causing serious injury or illness begin at the $7,000 maximum. If ICA made such a change it would be consistent with the policy it recently adopted for willful violations. ICA recently changed to using the statutory maximum of $70,000 for willful violations with a high probability of causing severe injury or illness. Previously, ICA had administratively set a maximum of $35,000 for these penalties.

Penalties often reduced after citations are issued — Even though cited penalties are generally small, ICA frequently reduces penalties after issuing citations. We found that 62 percent of all penalties issued by ICA for serious violations in calendar year 1993 were later reduced, with the median reduction being 25 percent.

Employers found in violation of workplace safety and health requirements have several options once they receive a citation from ICA. They have 15 working days to: 1) accept the citation, correct the violation, and pay the penalty; 2) hold an informal conference with an ADOSH supervisor to discuss the violation and negotiate an informal settlement agreement, or 3) formally contest the citation, resulting in a scheduled hearing before ICA's Administrative Law Judge (ALJ) Division or a formal settlement by ICA's Legal Division prior to the hearing.

Those who challenge citations issued by ICA often receive an additional reduction in their penalty amount. Our review of ICA penalty data for calendar year 1993 found that 62 percent of all penalties for serious violations were reduced. The median reduction in these cases was 25 percent, or $219. The median penalty for serious violations of workplace safety and health violations after reductions at informal and formal conferences was $563.

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1. According to the Department of Economic Security, in 1993, Arizona's average employer size was 16.95 employees. In Region IX, only Nevada had a larger average employer size. For example, California's average is 16.34, and Hawaii's is 15.66. According to the GAO, the average employer size in the United States is 15.27.

Even in cases involving willful violations or violations resulting in employees' injury or death, penalty amounts are frequently reduced after citations are issued. The following examples illustrate the reductions that can occur in these situations.

- In 1992, an employee of a swimming pool construction company was killed while working with a highly flammable chemical, acetone, in the deep end of a swimming pool. The employee used a wet/dry vacuum to remove some water that had accumulated overnight. The vacuum created a spark that ignited the acetone, creating a large fireball that burned over 70 percent of the employee's body and resulted in his death several days later. The employer was initially cited for three violations — two willful and one nonserious. The statutory maximum penalties for these violations would be $147,000. However, the employer was assessed a penalty of only $71,000 because the Commission used the administrative maximums in effect at that time rather than using the statutory maximum when calculating penalty amounts. These penalties were later reduced 58 percent, to $29,500, by ICA's Legal Division in a formal settlement agreement with the employer.[1]

- In 1993, an employee was severely burned, requiring hospitalization, after being directed to mix two chemicals that reacted violently and erupted from a steel drum. The employer was cited for not providing the employee with training on the use of these chemicals, and a $3,000 penalty was issued for this and another serious violation. The penalty was later reduced 25 percent to $2,250 after an informal conference because the employer promptly corrected the problem, even though correction is required in all circumstances under existing state law.

Reductions occur so frequently because ICA has a standard practice of offering 25 percent reductions to all employers who attend an informal conference and show a "positive attitude" toward safety. ICA officials said that this practice encourages employers to settle rather than contesting the penalty. In fact, only 95 cases were contested in fiscal year 1994, and only 14 of these cases went to hearing. ICA's concern is that without the additional 25 percent reduction, the number of employers contesting the citation amount will increase, thereby raising ICA's legal defense costs. However, because of the relatively low citation amounts overall, it seems unlikely that employers would invest their time and money for legal expenses to potentially save between $200 and $300 for a typical case.

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1. ICA also assessed the employer a $25,000 penalty to be paid to the victim's survivors when willful safety and health violations result in an employee's death. According to state law, the $25,000 is to be assessed in addition to other penalties.

RECOMMENDATIONS

1. To improve the effectiveness of the inspection scheduling program, ICA should:

   - Target employers with a history of serious violations
   - Review employer claims experience and target employers with high claims rates
   - Increase utilization of partial inspections
   - Improve recordkeeping and data analysis by developing a common employer identification number, tracking individual employer performance, and analyzing claims trends in employers and industries.

2. To strengthen the deterrent effect of penalties, ICA should:

   - Use the legal maximum as the starting penalty for violations with a high probability of causing severe injury and death
   - Discontinue the policy of giving a 25 percent reduction to employers at the informal conference stage.

FINDING II

GREATER EMPHASIS ON ACCIDENT PREVENTION NEEDED

Although ICA can better deter workplace injuries and illnesses by strengthening its enforcement program, greater emphasis on accident prevention is needed. With a ratio of 1 inspector to approximately 4,200 employers, ICA cannot directly regulate all Arizona worksites. ICA should require employers to accept more of their responsibility to identify and correct their workplace hazards. This could be accomplished by requiring employers to establish accident prevention programs. These programs have been found to reduce employee injuries and associated employer costs in other states. ICA has existing resources that could be used to provide consultation and training assistance to employers in developing such programs.

Accident Prevention Programs Needed to Reduce Injuries and Costs

Workplace safety and health programs can benefit both the employee and the employer. These programs are designed to prevent work-related injuries and illnesses through employee education and elimination of potential hazards. Studies have shown that accident prevention programs in other states have reduced injuries and costs.

Accident prevention programs are designed to identify, prevent, and control hazards that can lead to workplace injuries and illnesses. These programs often include a training component to raise employee awareness of safety and health issues. In addition, programs typically emphasize self-inspection and other self-assessment activities to identify potential hazards before injuries occur. Programs generally require top management involvement as well as the participation of workers at all levels of an organization.

Effective accident prevention programs have been established in a number of states. Federal OSHA contracted with Meridian Research, Inc., for a study of the costs, benefits, and effectiveness of workplace safety and health programs.[1] The resulting report, referred to as the *Meridian Report,* identified 11 states with responsibility for safety and health enforcement that have regulations or statutes requiring worker protection programs.[2] These

1. A report of the study's findings, entitled *Review and Analysis of State-mandated and Other Worker Protection Programs - Final Report,* was submitted to OSHA's Office of Program Evaluation on January 31, 1994.

2. These 11 states include Alaska, California, Hawaii, Michigan, Minnesota, New Mexico, Nevada, North Carolina, Oregon, Tennessee, and Washington.

programs have been found to be effective both in terms of reducing employee injuries and associated costs.

- **Programs reduce rates of injury and illness** — The *Meridian Report* indicates that companies with accident prevention programs consistently have injury and illness rates considerably below those of companies that have not actively implemented such programs. For example, the report indicates that a cable manufacturing company reduced its accident rate from two times to one-half the industry average after implementing an accident prevention program. The study also reports that a large Arizona copper mine with an accident prevention program has a safety performance three times better than the national average. In addition, a California Department of Insurance study found that employers, even in low-risk industries or those dominated by small firms, who have implemented workplace safety and health programs have reduced injuries and illnesses by an average of 40 percent. Oregon has also experienced significant reductions in injury and illness rates since reforming workplace safety and health programs in 1990.[1]

- **Cost savings for employers and state regulators** — According to the *Meridian Report,* employers save an estimated $3.50 to $5 for every $1 spent on accident prevention programs. These cost savings are due to reductions of injuries that resulted in lost work time and higher workers' compensation premiums and related costs. Not included are the secondary benefits of increased productivity, enhanced communication and morale, and improved employee-management relations. Meridian Research, Inc. estimated program costs to be approximately $149 per employee per year. State officials reported that accident prevention programs contribute to lower workers' compensation costs because of reductions in work-related injuries and illnesses. Officials in states requiring employer-operated workplace safety and health programs have also reported that these programs have improved inspection efficiency and have led to more effective use of limited state resources. In Oregon, workers' compensation insurance rates have declined each year since accident prevention program requirements were reformed in 1990. Oregon has estimated its savings in workers' compensation premiums to be over $200 million in 4 years.

The success of accident prevention programs has led to their endorsement by key organizations. For instance, the National Conference of State Legislatures (NCSL) recommends that states consider legislation requiring employers to develop safety plans or programs to encourage prevention of injuries and illnesses. In addition, the GAO has suggested

1. In addition to establishing accident prevention program requirements, Oregon also expanded the number of compliance and consultation officers in 1990.

requiring high-risk employers to develop safety and health programs. They recommended that OSHA implement evaluation procedures to determine what groups of employers should be required to have comprehensive safety and health programs.

Accident prevention programs could be required of all or a portion of employers. Regulations in Alaska, California, Hawaii, Nevada, and Washington apply to all employers, without exception. Other states limit coverage depending upon employer size, industry, or workers' compensation claims experience. For instance, Oregon requires accident prevention programs for: 1) employers with more than 10 employees, 2) employers with fewer than 10 employees and with lost workday incidence rates in the top 10 percent of their industry, and 3) employers with fewer than 10 employees and with workers' compensation premium rates in the top 25 percent.

ICA Has Resources Available to Help Implement Prevention Programs

ICA's Consultation and Training Section could assist employers in establishing accident prevention programs. Currently, few employers take advantage of the section's services. Refocusing the section's tasks could improve its effectiveness in helping businesses maintain safe workplaces.

ICA offers consultation and training services to employers at no cost. The Commission has allocated 11 FTEs to provide consultation and training services to employers. Employers contact ADOSH's consultation section and request that a consultant survey their worksite for potential safety and health hazards. ICA agrees to inspect but not cite violations if found. ICA reports their findings and requires the timely abatement of all hazards. Training programs developed by ICA staff are also available upon request to trade associations and individual employers. Courses are available in a variety of subject areas including forklift operation, excavation, roofing, and ergonomics.

Few employers utilize currently available consultation and training services. Although Arizona has more than 97,000 employers, only 631 requested consultations in fiscal year 1994. In addition, although ICA sent a letter in May 1994 to the 221 employers with 50 or more workers' compensation claims during the previous year recommending that they obtain consultation or training assistance from the Commission, only 5 employers had requested these services 75 days after the letter was issued.

If accident prevention programs are required, the Consultation and Training Section could shift its focus to helping employers set up programs.

RECOMMENDATION

To increase employer involvement in workplace safety and health, ICA should develop, for legislative consideration, a statutory change requiring employers in high-risk industries and employers with high incidences of workplace injuries to create accident prevention programs.

FINDING III

ICA CAN IMPROVE ITS WORKERS' COMPENSATION ADJUDICATION SYSTEM

ICA can improve its workers' compensation dispute resolution process. The increasing number of protested claims received by ICA hinders its ability to resolve contested cases in a timely manner and delays benefit payments to injured workers. To reduce the number of cases that go through the formal hearing process, ICA should adopt an informal dispute resolution program. In addition, for cases requiring formal hearings, delay can be minimized by using alternative techniques for obtaining medical testimony.

The Workmens' Compensation Act, the Youth Employment Act, and the Occupational Safety and Health Act require ICA to adjudicate all disputes of injured workers, employers, insurance carriers, and other interested parties. ICA has established an Administrative Law Judge (ALJ) Division, with assistance from the Claims Division, to perform this function.[1] Workers' compensation claims are received by the Claims Division, which then notifies the insurance carrier. The insurance carrier can either accept or reject the claim. Any interested party can then request a hearing on the claim before an Administrative Law Judge. A hearing request can be based on many issues including compensability, claim reopening, continuing of benefits, or loss of earning capacity disputes.

Disputed Claims Need Timely Adjudication

Timely processing of disputed claims is important to avoid undue hardship to injured workers if, in fact, they are entitled to compensation. The following example illustrates the delays that can occur:

- On October 24, 1991, a construction worker fell and was injured while working on stilts. He was provided compensation and medical treatment benefits until May 14, 1993, at which time they were terminated by the insurance carrier, with the conclusion that there was no permanent disability. On June 10, 1993, the injured worker filed a

1. The ALJ Division employed 21 Administrative Law Judges and 33 additional staff and expended $3,619,400 in fiscal year 1992-93, representing the largest budgeted area at ICA. The Claims Division funded 83 positions and expended $2,530,200 in fiscal year 1992-93. Together, these divisions accounted for 46.7 percent of ICA's total fiscal year 1992-93 budget.

protest with ICA, claiming that medical treatment was still needed and that there was a permanent injury. ICA initially scheduled a hearing for this matter on October 21, 1993, 113 days after the notice of hearing was mailed and 53 days longer than ICA's standard (at the time) of 60 days. The hearing was reset for January 19, 1994, to allow combining this protest with one filed for the same worker on another injury. At the January 19, 1994, hearing it was decided that further medical testimony was needed and a follow-up hearing was scheduled for February 17, 1994. That hearing was postponed because the doctor could not attend. Subsequent hearings to obtain medical evidence were held on March 4, March 31, and April 4, 1994. The ICA administrative law judge who heard the case issued a final order on April 12, 1994, awarding further medical treatment and ruling that a permanent partial disability did occur. Thus, the injured worker's protest was substantiated and the insurance company was liable for continued compensation and medical costs. However, during the 10-month timeframe from the worker's protest of discontinued benefits until ICA restored them, the worker did not receive any medical or compensation benefits.

ICA's Current Adjudication Process Is Overburdened

An increase in the number of workers' compensation claims has negatively impacted the agency's adjudication system. A case backlog has developed that can be attributed to an increasing caseload, which is expected to grow. In addition, our review found it took twice as long to hold the initial hearing than the department's goal stipulated at the time of our review.

Cases referred to hearing are increasing — The number of protested claim cases referred to the ALJ Division for hearing has grown over the past three years and further increases are expected in the years ahead. As shown in Table 2 (see page 21), the number of workers' compensation cases referred to the ALJ Division rose from 8,406 cases in fiscal year 1991-92 to 10,301 cases in fiscal year 1993-94, an increase of 23 percent. This trend is expected to continue. By fiscal year 1996-97, it is anticipated that the ALJ Division will receive approximately 14,000 protested claims cases. Assuming no change in current staff levels, the caseload per judge is expected to increase nearly 60 percent between fiscal years 1991-92 and 1996-97.

Initial hearings are delayed — Formal hearings to resolve disputes have not been held in a timely fashion. We examined 100 protested claims cases closed in calendar year 1993 and found it took a median time of 126 days from the time the protest was scheduled for hearing until the hearing was actually held. ICA's informal policy until July 26, 1993, was to convene initial hearings 60 days after the case was scheduled for hearing by the ALJ Division. After July 26, 1993, ICA revised its policy to convene initial hearings in 90 days.

Table 2

Administrative Law Judge Division
Historic and Projected Workers' Compensation Caseloads[a]

Fiscal Year	Cases Referred to ALJ Division	Number of Judges (FTEs)	Ave. No. of Cases Per Judge
1991-1992	8,406	21	400
1992-1993	9,538	21	454
1993-1994	10,301	21	491
1994-1995 (b)	11,400	22	519
1995-1996 (b)	12,600	22	574
1996-1997 (b)	14,000	22	636

(a) Projections were calculated by using the average increase for the previous three years.
(b) Estimated.

Source: Auditor General Staff analysis of caseload and staffing information provided by ICA's ALJ Division.

An Alternative Dispute Resolution Program Could Reduce the Number of Cases Requiring Formal Hearings

ICA should consider modifying its existing adjudication process to include informal resolution methods to resolve disputed cases. Methods such as prehearing settlement conferences and conciliation could decrease the number of disputed cases that require a hearing, thereby minimizing benefit payment delays to applicants.

Establishment of an alternative dispute resolution (ADR) program could enable ICA to better accommodate its growing caseload by limiting the number of cases that require a formal hearing. In mid-1993 the Industrial Commission strongly encouraged judges to seek case resolution prior to hearings if possible. As a result, currently about 50 percent of all cases referred to the ALJ Division are resolved by outside parties (such as the claimant, insurance carrier, or employer), before a hearing takes place. However, our review of ADR systems found that ICA could further reduce the number of cases that require a formal hearing. ICA's Chief ALJ concurs, estimating that at least 25 percent of the Division's remaining caseload could be reduced through mandatory prehearing settlement conferences.

Instead of relying on outside party efforts to informally resolve a dispute, ALJ's could assume a more active role by conducting prehearing settlement conferences similar to those held by the Maricopa County Superior Court. These conferences are held approximately two weeks before going to formal hearing and involve the plaintiff, defendant, judge, and applicable attorneys. A Superior Court judge estimated that prehearing settlement conferences have allowed the Maricopa County Superior Court to successfully decrease its scheduled formal trial caseload by about 50 percent.

A prehearing settlement conference is not the only option available to ICA, however. Our review of other state programs showed that ICA could implement a conciliation process similar to Massachusetts'. Conciliation is an informal meeting between the injured party, the insurer, and an in-house conciliator and takes place within 15 days of a claim's receipt. Its purpose is to reach a voluntary agreement between the injured party and the insurer before the case is referred to the next step in the process. The Massachusetts Workers' Compensation Advisory Council estimated that conciliation successfully resolves 46 percent of the disputed cases.

Regardless of the ADR method that ICA chooses, it should ensure that the method selected will sufficiently reduce the number of cases that currently proceed to hearing. Hence, to assure that the selected ADR method will be effective we recommend first implementing it as a pilot program.

Changes Can Also Benefit Cases That Proceed Through the Hearing Process

For those cases that proceed further in the hearing process, ICA could reduce delays caused by subsequent hearings if it utilized alternative methods for obtaining testimony. Currently, ICA uses subsequent hearings to obtain medical testimony, extending the hearing process and delaying a judge from issuing a decision. By redesigning the way medical testimony is obtained, ICA can reduce delays.

Subsequent hearings lengthen the process — Our analysis of 100 protested claims cases showed 57 percent of these cases heard by the ALJ Division had at least one additional hearing. These subsequent hearings, which typically are held to obtain doctors' testimony, extended the process a median of 54 days for the initial subsequent hearing and even longer for additional hearings.

The following example illustrates how subsequent hearings can prolong the process:

- A case involving a roofing foreman took 269 days to resolve because multiple hearings were needed to obtain medical testimony. The applicant suffered an injury to his right knee, hip, and back when he fell through a roof. Due to continuing back problems, he filed a petition to reopen his claim. The petition was denied and the applicant requested a hearing on June 30, 1992. On October 20, 1992, an initial hearing was held and a subsequent hearing was scheduled for January 27, 1993, to obtain additional medical testimony from two doctors. Only one doctor appeared at this hearing, so a third hearing was scheduled for February 24, 1993, to obtain the second doctor's testimony. On March 26, 1993, after a lengthy hearing process, a decision was finally issued.

Subsequent hearings can be reduced — Interviews with officials from other states, Arizona attorneys, and ICA's Administrative Law Judges indicated that other alternatives for obtaining medical testimony are available that could lessen delays associated with subsequent hearings. For example, telephone conferences could be a viable alternative to live medical testimony. These conferences allow doctors to remain at their offices when giving testimony instead of requiring them to appear in court. This option can shorten the hearing process since telephone conferences can be scheduled sooner than live medical testimony. State law, however, may not allow for mandatory telephone conferences. According to some legal experts, if either party or the judge wants to "see" the witness, they have the right to do so. Telephone conferences could certainly be used, however, if both parties stipulate their approval. For example, Nevada's regulations allow for telephone conferences if the witnesses' qualifications are not challenged.

Other choices are available to the ALJ Division to reduce the need for live medical testimony. An ICA review of other states showed that some states rely on medical depositions and standardized medical reports. For example, Maine, Michigan, and Ohio use medical depositions to obtain a doctor's testimony. Wisconsin and Tennessee use standardized medical reports. Currently, ICA uses medical reports, but they are not uniform. The National Conference of State Legislatures recommends requiring standardized reporting by health care providers. Standardized reporting would allow ICA to ensure that doctors provide all information typically needed to make protest decisions.

Whatever alternative ICA chooses, if properly used, would either reduce the number of subsequent hearings held and/or shorten the time it takes to schedule a subsequent hearing, thereby shortening the hearing process.

RECOMMENDATIONS

1. ICA should pilot test an alternative dispute resolution program to reduce the number of disputed cases that go to hearing.

2. ICA should adopt other methods, such as telephone conferences, medical depositions, and standardized medical reports, to obtain medical testimony.

FINDING IV

ICA NEEDS TO IMPROVE ENFORCEMENT EFFORTS AGAINST UNINSURED BUSINESSES

Current program efforts appear to do little to encourage compliance with the mandatory workers' compensation insurance law. Monies paid out annually by ICA to cover the costs of claims filed by injured employees of uninsured employers have grown 388 percent since our 1984 audit. ICA's efforts to recover medical costs paid by the Special Fund and to penalize uninsured employers have been weak and do little to encourage compliance with insurance requirements. In addition, ICA lacks an adequate mechanism for identifying uninsured employers before workers' compensation claims are received.

Arizona Revised Statutes (A.R.S.) §§23-902 and 23-961 require most employers to secure workers' compensation for their employees by obtaining insurance from an authorized carrier or by furnishing the Commission with satisfactory proof of financial ability to self-insure. For injured employees of employers who fail to obtain insurance, the State has a Special Fund, with current assets of approximately $200 million, that covers medical and rehabilitative costs. Employers without insurance have an unfair advantage over those who comply with the law because they are not paying workers' compensation insurance premiums or the surcharge on those premiums that is used to support ICA operations and the Special Fund. According to figures provided by the Arizona Department of Insurance, businesses on average paid over $10,000 for workers' compensation insurance in 1993. Premiums are based on job risk for injury and total payroll. For example, a 5-person clerical firm would pay approximately $500 annually, whereas a 5-person roofing contractor could pay as much as $29,220 annually. Statutes allow ICA to pursue employers without insurance to: 1) recover costs borne by the Special Fund and 2) assess penalties for operating without insurance.

No-Insurance Claims Have Caused Significant Increases In Special Fund Payments

Payments made from ICA's Special Fund for no-insurance claims have grown substantially over the past 10 years, while repayment of those claims by the non-insured businesses has remained low. Previously, we found that payments for no-insurance claims grew from $448,000 in 1979 to $984,000 in 1983. Since that time, disbursements for no-insurance claims have grown to nearly $5 million annually. As shown in Figure 1 (see page 26), ICA paid out approximately $4.8 million for no-insurance claims in 1993, a 388 percent increase over disbursements only 10 years earlier[1].

1. This growth has occurred despite a reduction in the number of no-insurance claims accepted for payment over the past five years.

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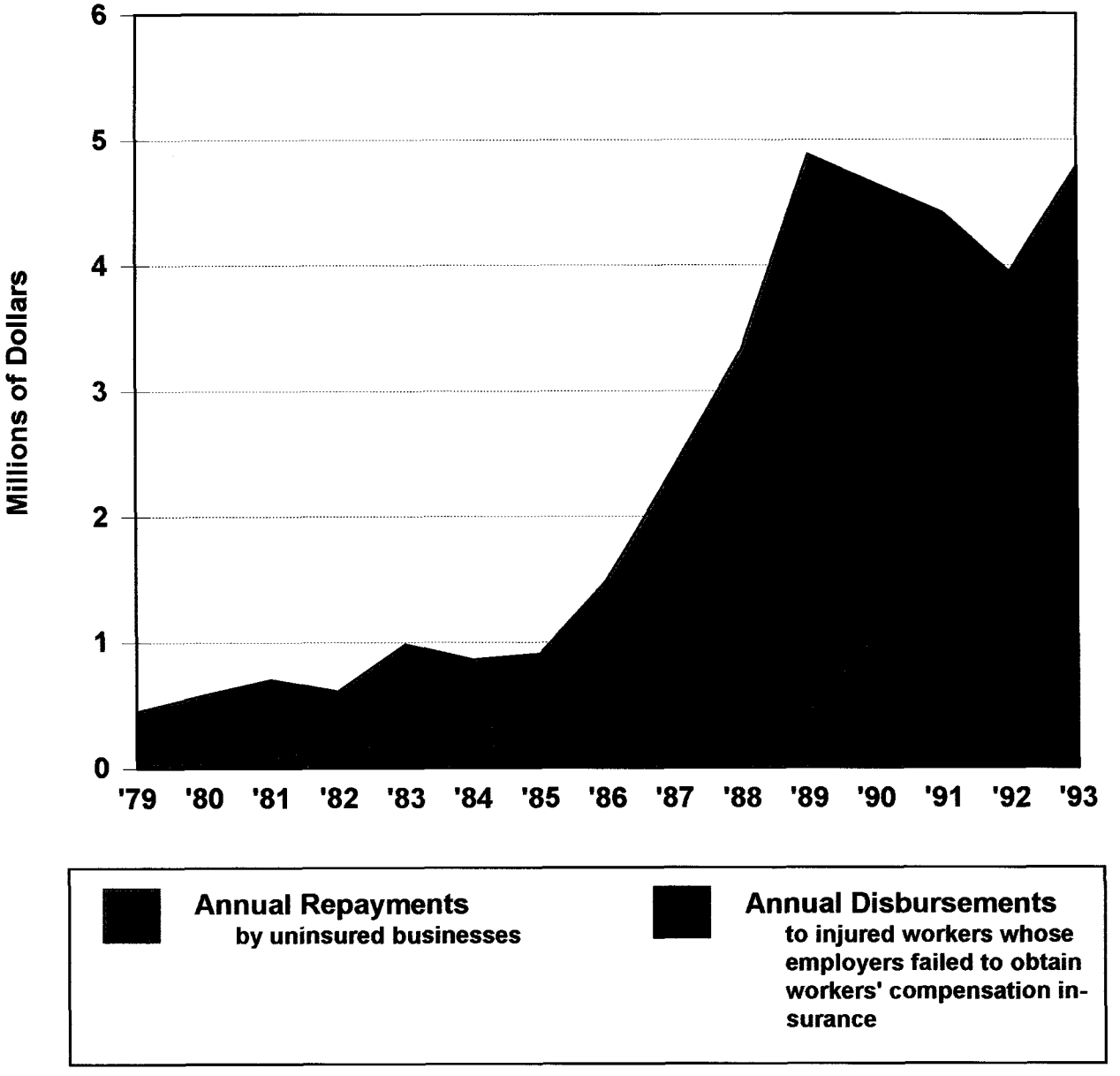
Figure 1

Annual Disbursements and Repayments of No-Insurance Claims 1979 through 1993



Source: Compiled from Special Fund disbursements and reimbursement information provided by ICA's Legal Division.

However, the Commission continues to recover only a small fraction of the monies owed to the Special Fund by employers responsible for no-insurance claims. As reported in our 1984 audit report, ICA recovered only 15.9 percent of the monies paid out for no-insurance claims between 1979 and 1983. For the 5-year period ending in December 1993, ICA recovered only $4,214,309 (or 18.6 percent) of the $22,675,759 in total no-insurance claims disbursed from the Special Fund.[1]

Enforcement Appears Weak and Is Impacted by Backlog of Cases

Without strong enforcement of the no-insurance laws, employers have little incentive to obtain workers' compensation insurance. Our review of ICA's enforcement efforts found that ICA does not always utilize the enforcement tools allowed by statute. In addition, the enforcement unit suffers from a large backlog of cases. ICA needs to analyze various alternatives for addressing the backlog.

ICA's Legal Division investigates and enforces against uninsured businesses. The Division utilizes one attorney, a legal secretary, and a part-time investigator to handle cases. After processing and investigating, the Legal Division determines sanctions and penalties that will be applied against no-insurance offenders.[2] The Division first attempts to collect monies owed using its own staff. However, if that is not successful, cases are then referred to the Attorney General's collections unit. In fiscal year 1993-94 the Division received 1,144 referrals for collection, and 1,797 complaints concerning uninsured employers.

Enforcement tools not consistently applied — Our review found that ICA does not consistently utilize or apply the enforcement tools available against no-insurance violators. Our review of a random selection of 30 cases from fiscal year 1992-93 found ICA rarely takes enforcement actions against violators. For example, in 9 of 30 cases, ICA's Special

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1. According to ICA, some monies are not collected because businesses have declared bankruptcy. ICA estimates that approximately $3.8 million was uncollectable due to bankruptcies between 1990 and 1993. However, even with this accounted for, there was still over $10.2 million that was not collected during this same time period.

2. ICA is authorized by A.R.S. §23-907 to issue penalties to those violating workers' compensation insurance requirements. Subsection C requires ICA to assess a penalty of 10 percent of the amount disbursed from the Special Fund or $500, whichever is greater, to uninsured employers whose employees have received workers' compensation benefits through the Special Fund. Subsections F and G of the statute authorize the Commission to assess civil penalties of up to $500 against uninsured employers.

Fund Division never forwarded these cases to the Legal Division for enforcement. The Special Fund Division previously had an unofficial policy of closing cases if the employer paid the medical and other costs and subsequently obtained insurance. According to the Special Fund monitor, the policy was revised in fiscal year 1992-93 to refer all claims to the Legal Division. We found, however, that some claims in fiscal year 1993-94 were not referred. Nonreferral of these claims to the Legal Division results in no penalty to employers for failure to carry required insurance.

ICA appears reluctant to act even when faced with repeated violations or broken promises. In one case, ICA waived penalties three times on an employer that had more than 20 no-insurance violations. That same employer had also obtained insurance two previous times and had canceled the first policy once and let the second expire another time. Another case revealed that although an uninsured employer had agreed in February 1994 to pay $305 monthly on a debt of $13,000, ICA had yet to receive a payment as of September 1994, and there was no indication of any follow-up action by ICA to collect.

Large case backlog impacts timely enforcement — The Legal Division has not been able to process and investigate no-insurance cases in a timely manner. As of February 1995, 112 cases dating back to February 1994 that should be referred for outside collection have yet to be processed. In addition, 454 referrals regarding employers with no insurance dating as far back as June 1994 have yet to be processed and investigated. Further, another 568 cases are at various stages of the process. The backlog has not decreased since the time we initially reviewed it in October 1994. ICA currently has a full-time clerk and an attorney who devotes partial time toward no-insurance enforcement. To reduce the backlog and improve timeliness, ICA needs to analyze whether its processes could be made more efficient, whether staff from other ICA units could be utilized to reduce the backlog, or whether ICA could contract out some of the work. According to ICA, one additional staff was added in its recent legislative budget appropriation. Again, ICA will need to monitor its backlog to determine if this additional staff is sufficient or if other measures or staff would be needed.

More Can Be Done to Identify Uninsured Employers Before Injuries Occur

ICA can do more to identify uninsured employers before no-insurance claims are received. Since our last audit of the agency, we found that ICA has had little success in implementing programs to effectively identify uninsured employers. Specifically, our 1984

review of the agency recommended that the Commission proactively work to identify uninsured employers. While the agency has taken some positive steps, these measures have had limited success. For example:

- **ICA has been unsuccessful in developing an automated approach to identifying noncompliers** — In 1991, ICA attempted to identify uninsured employers by comparing its employer database to yellow page listings through a software package. However, ICA stopped using the package one year later when it was discovered that employer names used in the software package were not compatible with names from the ICA files.

- **Notification cards are not being used to identify uninsured employers** — Statutes require that a carrier notification card be sent to ICA each time an employer obtains new coverage, cancels his or her policy, or fails to renew coverage. ICA abandoned the use of these cards as a means of identifying uninsured employers after it was determined that the agency lacked the necessary resources to investigate these referrals. The carrier notification cards are still used to update ICA's existing database, and these cards could still be used to identify uninsured employers.

Although ICA has attempted to improve the manner in which it identifies uninsured employers, two additional strategies should be implemented to enhance uninsured employer identification.

- **Develop a compliance database using the federal tax identification number** — With more than 97,000 employers in the State, ICA's potentially most effective strategy for identifying uninsured employers is the use of computer matching. ICA needs to develop a database for such matching. A key component of such a database is establishing a unique identifier for each employer. The federal taxpayer number is a unique identifier and is already maintained by other federal and state agencies with whom ICA might want to match computer files. If ICA has these numbers for the employers, and if the carrier notification cards described above are modified to include them, then ICA can routinely do computer matching to determine if the employers are maintaining coverage.

  Further, using these numbers, ICA could cross match its database with those of other agencies to identify uninsured employers. For instance, ICA could compare its database with the Arizona Department of Economic Security's (DES) database of employers with unemployment insurance to identify potential noncompliers. DES officials are authorized by A.R.S. §23-722 to share employer information with public employees in other state agencies, and have expressed a willingness to assist ICA both in the de-

velopment of a compliance database and the ongoing comparison of data to identify uninsured employers. DES' database contains such information as the federal tax identification numbers, business names, and business addresses.

The Arizona Department of Revenue (DOR) also maintains automated data regarding Arizona employers that could prove useful to ICA. However, A.R.S. §42-108 currently restricts DOR from sharing confidential tax information with non-taxing agencies. The Department's General Counsel indicated that DOR would be willing to work with ICA to eliminate these restrictions if suitable data could not be obtained from other sources.

- **Coordinate with other agencies to identify uninsured employers** — ICA should work with other governmental entities to secure the names of uninsured employers. For instance, legislation recently passed requiring the Registrar of Contractors to obtain proof of workers' compensation insurance before issuing or renewing a license. ICA could develop agreements with other governmental agencies to check employer compliance with workers' compensation insurance requirements and notify the Commission when noncompliers are found.

RECOMMENDATIONS

1. ICA should consistently apply penalties against employers who fail to obtain workers' compensation insurance.

2. To address the backlog of no-insurance enforcement cases, ICA should examine processes for potential improvement, consider reallocating resources to bolster compliance and collection efforts, or determine whether some functions could be handled using outside contractors.

3. ICA should develop programs to monitor compliance with mandatory workers' compensation insurance requirements.

   a. ICA should develop a new database, or modify its existing employer database, to help it identify uninsured employers. The database should include a unique identifier for each employer, such as the employer federal tax identification number.

   b. ICA should modify existing carrier notification cards to capture employer federal taxpayer numbers.

   c. The agency should consider matching ICA data against employer information maintained by the Department of Economic Security.

4. ICA should investigate the possibility of working with other governmental entities to identify existing uninsured employers.

SUNSET FACTORS

In accordance with A.R.S. § 41-2954, the Legislature should consider the following 12 factors in determining whether the Industrial Commission of Arizona should be continued or terminated.

1. Objective and purpose in establishing the Commission.

Originally created in 1925, the Industrial Commission was established to administer and regulate workers' compensation, ensure safety in the workplace, license employment agencies, and generally administer and enforce all laws for the protection of life, health, safety, and welfare of employees, where such duty is not specifically delegated to others.

While the purpose of the agency has remained unchanged, the Industrial Commission was substantially reorganized in 1968. The original Commission, which functioned as a state-owned insurance company with authority to regulate all other insurers providing workers' compensation coverage in the State, was restructured when legislation created a separate agency, the State Compensation Fund. In addition, the Arizona State Department of Insurance assumed the duty of licensing workers' compensation insurance carriers.

2. The effectiveness with which the Commission has met its objectives and purpose and the efficiency with which the Commission has operated.

ICA appears to be generally well-managed and sufficiently carrying out its duties. ICA, however, can improve its effectiveness and efficiency in fulfilling its statutory responsibility to protect public health, safety, and welfare. Our review found that ICA's enforcement of occupational safety and health requirements could be improved by targeting those employers most likely to have violations and by discontinuing the practice of providing an additional 25 percent reduction in penalties for violations (see Finding I, pages 5 through 14). In addition, while the agency is timely in processing undisputed workers' compensation claims, we found that the Commission should implement an informal dispute resolution program to reduce the number of disputed cases that require a formal hearing and shorten the timeframe of cases requiring a hearing (see Finding III, pages 19 through 24). Finally, ICA could improve its efforts to enforce employer compliance with mandatory workers' compensation insurance requirements (see Finding IV, pages 25 through 30).

3. The extent to which the Commission has operated within the public interest.

ICA has operated within the public interest through its administration of programs to protect employee health, safety, and welfare. For instance, the Commission operates an occupational safety and health program that seeks to minimize injuries and illnesses through inspection, enforcement, and educational efforts. In addition, ICA oversees Arizona's workers compensation system. In fiscal year 1993-94, ICA received over 180,000 workers' compensation claims and was asked to adjudicate more than 10,000 protested claims. The Commission also administers the Special Fund, which is used to provide benefits to injured workers whose employers fail to carry required workers' compensation insurance. Finally, the agency's operations have benefited workers, employers, and the general public through various activities including its elevator inspection program, wage dispute resolution program, and employment agency licensing program.

However, the Commission could do more to operate in the public interest by targeting for inspection those workplaces most likely to have serious safety and health problems and placing greater emphasis on accident prevention. The agency could also do more to adequately assess penalties that are designed to discourage employers from violating laws designed to safeguard the public. Furthermore, the agency could implement an alternative dispute resolution program to expedite its workers' compensation adjudication process, thereby minimizing benefit payment delays to injured workers.

4. The extent to which rules adopted by the Commission are consistent with the legislative mandate.

Based on our limited review and according to the agency's Chief Counsel, all rules promulgated are consistent with each division's legislative mandate.

5. The extent to which the Commission has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

The Industrial Commission is proactive in seeking input from the public before promulgating its rules. For example, for rules pertaining to hearing procedures and bad faith/unfair claims processing, the Commission appointed a committee made up, in part, of representatives of outside interested parties who actually helped develop the proposed rules. In other cases, proposed rules have been submitted to the public for further comment during public hearing. The Commission holds regular meetings to discuss such administrative matters. Our review found these meetings are appropriately posted in compliance with the open meeting law.

The Industrial Commission uses several avenues to keep the public informed of its actions. According to the agency's Director, the Arizona Division of Occupational Safety and Health (ADOSH) sends out a newsletter to interested parties and organizations while its Claims Division conducts an annual seminar/workshop for insurance carriers, self-insured employers, workers' compensation attorneys, and others interested in the field to inform the industry of major program changes. Additionally, mini-seminars are put on by the Administration, ADOSH, and Claims Divisions.

6. The extent to which the Commission has been able to investigate and resolve complaints that are within its jurisdiction.

A.R.S. §23-107(B) provides that the Commission has the authority to investigate complaints made by any person involving workplace safety. Complaints, regardless of type, are investigated and resolved by various divisions within the agency. For example, workers' compensation complaints are investigated by the Claims Division; occupational safety and health-related complaints by ADOSH; and issues involving child labor laws, employee paid fee employment agencies, career counselors, and wage claim law by the agency's Labor Division. Furthermore, the Commission investigates and resolves complaints that relate to licensing of self-insured employers, and the Legal Division if they relate to uninsured employers.

Our review of the agency's complaint resolution processes found that ICA's Legal Division has a backlog of complaint referrals pertaining to uninsured employers. (See Finding IV, pages 25 through 30.) All other types of complaints are investigated and resolved in a timely manner.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.

The Industrial Commission's Chief Counsel prosecutes the citations and penalties issued by the divisions of the agency. Criminal sanctions can be prosecuted by the agency's Chief Counsel, State Attorney General, or County Attorney on behalf of the State, depending on the violation.

8. The extent to which the Commission has addressed deficiencies in its enabling statutes which prevent it from fulfilling its statutory mandate.

Several changes have been made to agency statutes over the years and several bills were passed in the years 1990, 1991, and 1992. In 1990, Senate Bill 1187 amended A.R.S. §23-1061, which remedied an inequity requiring a claimant to file a petition to reopen a claim before receiving emergency medical care. In 1991, Senate Bill 1021 amended the State's Administrative Procedures Act which allowed the Industrial Commission to adopt federal standards within the guidelines allowed by

the U.S. Department of Labor, Occupational Safety, and Health Administration. Furthermore, in 1992, Senate Bill 1059 amended A.R.S. §23-418 which provided for significant increases in penalties for State Occupational Safety and Health violations.

9. The extent to which changes are necessary in the laws of the Commission to adequately comply with the factors listed in the subsection.

Based on input from ICA, the Legislature should consider requiring employers in high-risk industries and employers with high incidences of workplace injuries to implement accident prevention programs (see Finding II, pages 15 through 18).

10. The extent to which the termination of the Commission would significantly harm the public health, safety, or welfare.

Termination of the Commission could significantly harm the public health, safety, and welfare as it could lead to less employee protection. In addition, the State General Fund would lose in excess of $1 million dollars annually in revenues from penalties collected under its OSHA program. This would impact other state activities such as the Department of Agriculture's Workers' Safety Training Program which is specifically funded from these revenues.

11. The extent to which the level of regulation exercised by the Commission is appropriate and whether less or more stringent levels of regulation would be appropriate.

The current level of regulation appears generally appropriate. However, to maximize workplace safety and health throughout the State, we found that the State should place more emphasis on the employers' responsibility for worker safety and health. Specifically, ICA should request a statutory change requiring certain employers to develop accident prevention programs (see Finding II, pages 15 through 18).

12. The extent to which the Commission has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.

Private contractors are used extensively by the Agency for activities such as investment, collection, hearings, and janitorial services. Due to the nature of the functions of the agency, ICA's use of private sector contractors appears to be appropriate. Our audit work does not indicate the need for further private sector contracting.

THE INDUSTRIAL COMMISSION OF ARIZONA

GAY CONRAD KRUGLICK, CHAIRMAN
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GORDON MARSHALL, MEMBER
MIKE PETCHEL, MEMBER
LUIS M. RODRIGUEZ, MEMBER

LARRY ETCHECHURY, DIRECTOR
TERESA HILTON, SECRETARY
(602) 542-4411

P.O. BOX 19070
PHOENIX, ARIZONA 85005-9070

LARRY ETCHECHURY, DIRECTOR
(602) 542-4411
FAX (602) 542-3104

June 1, 1995

Mr. Douglas Norton, Auditor General
Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Dear Mr. Norton:

The following is the Industrial Commission of Arizona's (ICA) response to the Performance Audit conducted in accordance with A.R.S. §41-2954.

Response to Finding I

While we agree that there is always room for improvement, we generally disagree with the Auditor's premise, in Finding I, that the ICA needs to strengthen workplace safety and health enforcement.

First, the ICA believes that its targeting system does adequately identify those worksites where injuries and illnesses are occurring or are most likely to occur. In the latter part of 1992, the ICA developed an inspection scheduling system for fixed sites utilizing workers' compensation claims data. This system produces a computer generated report listing every employer who has five or more claims per year. The ICA's compliance supervisors review this report, exclude those that are on the list simply because of their size, or those that have recently been inspected, and schedule those remaining employers for an inspection. Additionally, employee complaints received regarding employers on the claims list are scheduled for comprehensive inspections irrespective of the items contained in the complaint. A "claims inspection" includes an analysis of claims history and the causal factors associated with each claim. A comprehensive inspection is conducted of the employer's facility, violations of occupational safety and health standards are cited and serious violations are assessed penalties. If causal factors for workers' compensation claims go beyond those violations cited, the ICA includes its safety and health recommendations to the employer in a letter.

After reviewing the results of inspections conducted using this system, we noted a 17% increase in the number of serious violations. Even more important is the fact that citations and recommendations resulting from these inspections can be directly related to the causes of injuries and illnesses. While the ICA readily agrees that refinements can be made to this system, we

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believe that this system does what was intended - identify those employers incurring the injuries and illnesses in our state.

As to the Auditor General's premise that penalties are too low, the ICA again respectfully disagrees. The penalty system utilized by the Arizona Division of Occupational Safety and Health (ADOSH) is exactly the same as that utilized by the U. S. Department of Labor's Occupational Safety and Health Administration. Annually, the Federal government reviews all elements of ADOSH's program and has concluded that the penalties assessed were appropriate given the average size of employers inspected, which was approximately one-half of the size of those employers inspected nationally.

The Commission reviews all proposed ADOSH penalties (over $200) and modifies those proposals as necessary depending upon the circumstances, exposures and severity of the hazard being addressed. The maximum penalty assessed to an employer by the Commission has been $160,000. In almost all of the penalties approved by the Commission, Commission members, who range in background from representatives of organized labor to small and large business representatives, have unanimously agreed on the penalties assessed. The Commission's decisions regarding penalties have also been reviewed by the federal government, and they have concluded that the resultant penalties have been appropriate. Accordingly, the ICA feels very confident that the penalties assessed appropriately reflect the hazards identified.

As to the reduction of penalties, it is true that the majority of penalties protested are reduced within an average range of 19% to 21%. The rationale and importance of the reductions are the issues with which we disagree with the Auditor General.

After a citation (and a penalty) is issued, and during the informal conference/protest period, if an employer agrees to correct the violations and establishes a commitment to be more proactive with its safety and health program, then the penalties may be reduced a maximum of 25%[1]. This policy has resulted in the following actions:

(1) Less resources spent in litigation. Compliance officers are able to conduct more inspections without having to spend their time testifying in court. Attorneys can spend their resources on litigating the more

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[1] This policy is in effect and applies to all employers except those in which the Commission determines the violations to be egregious (most failure to abate, repeat and willful violations).

serious/significant cases. Also, judges can spend their resources on other cases such as workers' compensation disputes.

(2) It encourages an employer to make a commitment with respect to its safety and health program. This provides an incentive to implement an effective program that will result in reduction of injuries and illnesses long after ADOSH has left the premises.

(3) Abatement of violations are accomplished faster which also results in fewer injuries/illnesses. If a citation is protested, violations are not required to be abated until after the issue is resolved in a hearing, approximately 90 to 120 days later. When the citation becomes final, follow-up inspections are conducted to verify abatement of all serious, repeat willful and failure to abate citations.

Accordingly, the Commission believes its current practice of selective reduction of penalties serves an important purpose in providing a necessary balance between appropriate enforcement, encouragement of employers' safety and health efforts and effective utilization of resources.

The mission statement of the Arizona Division of Occupational Safety and Health is to reduce injuries and illnesses by ensuring that employers comply with occupational safety and health standards and recognized safety and health practices. From 1984 through 1993, on a per capita basis, Arizona's Loss Work Day Incidence Rate has decreased 19% and its overall injury and illness incidence rate has decreased 11%. This is particularly important when one realizes during that same period employment increased 31%. These Arizona reductions are significantly higher than comparable national data, which in all probability had higher penalties assessed per violation. Given these results, the Commission feels that the level of safety and health enforcement in Arizona is appropriate.

Response to Finding II

The ICA agrees with the Auditor General's Finding II recommending a requirement for employers to establish mandatory accident prevention programs. Since this finding would require legislative action, the ICA recommends that if the legislature concurs with the need for this legislation, that it approach the subject with positive incentives instead of the typical regulatory format utilized by our bordering states.

The Commission recommends legislation that would provide a reduction in workers' compensation premiums (in the neighborhood of 5%) if employers (all employers irrespective of size) had in

place a formal safety and health program and their injury and illness experience was average or better. (An effective measure could be an experience modification rate of 1.0 or lower, which could be evaluated annually by their workers' compensation insurance carrier). In our opinion, this would provide a positive incentive for employers, particularly smaller employers, to be more proactive with their safety and health programs. ADOSH's Consultation and Training Section and workers' compensation insurance carriers are available to provide technical assistance to employers at no charge.

Response to Finding III

The ICA agrees with the Auditor General's Finding III that ICA can improve its workers' compensation dispute resolution process. The Industrial Commission, in 1992, prior to the Auditor General's audit, began the process of conducting an extensive review of the hearing process relative to disputes over workers' compensation claims. As a result of that review, in July 1993 the Commission established an alternative dispute resolution program utilizing prehearing settlement conferences to attempt resolution of disputes without the need for an administrative hearing. The results of that program were successful. Approximately 40% of the cases were resolved without the need for a hearing. Since that time, another type of (pilot) alternative dispute resolution program, similar to Maricopa County Superior Court settlement conferences, has been implemented. The Administrative Law Judges selected for this program have been formally trained by a Superior Court Judge familiar with settlement conferences and we have in excess of 35 cases which are currently included in the program. The ICA will be evaluating the results of this pilot program to determine if more widespread implementation is necessary.

Currently, it is taking 122 days from the date a request for hearing is filed to the date of the initial hearing. With the recent hiring of three vacant judge positions, the ICA is anticipating that period (for the initial hearing) to be reduced to 90 days by the end of the year.

The issue of further hearings has been a longstanding problem. We are reviewing various options to reduce the delays caused by those further hearings.

Response to Finding IV

The ICA agrees with the Auditor General's Finding IV recommending that the ICA improve its enforcement efforts against uninsured employers.

Since the last audit report, the ICA has increased its enforcement and collection efforts dramatically. We have made

legislative changes to increase enforcement activity. To enhance our collection efforts, the ICA has litigated bankruptcy cases to establish legal precedents. The ICA has added personnel in the past and in FY '96 will be adding another person. Yet, with all of this, given existing bankruptcy laws and the precarious financial stability of the uninsured employer population; our success, after the fact, in recovering costs has been limited.

As the Auditor General has recommended, our greatest success will come if the ICA can access a complete employer data base. This will allow us to find employers without workers' compensation insurance before injuries and illnesses occur. The only complete data base we know of is found with the Department of Revenue (DOR). The important information in this data base are the names and addresses of Arizona employers.

While the Auditor General does mention Federal I.D. numbers, given the confidentiality constraints related to divulging Federal I.D. numbers, in all probability, the ICA will not be able to cross-match Federal I.D. numbers (insurance companies who provide coverage information to the ICA cannot compel an employer to provide a Federal I.D. number because of confidentiality laws). Nevertheless, the ICA will be able to cross-match by name and address, which is a significant advance over what currently exists.

As to accessing Department of Economic Security Unemployment Insurance data base, the ICA has been told by the supervisor in that section that since they utilize DOR's information, the ICA cannot access their data base because of the confidentiality restrictions placed upon them by DOR. Currently the ICA is in discussions with DOR to attempt to gain access under Title 42 as a taxing agency. We are hopeful that this can be accomplished administratively, without the need for additional legislation.

Mr. Norton, in closing, I would like to say that even though the performance audit process is a long and certainly involved one, the Commision appreciates the professional manner in which your auditors have conducted themselves.

Sincerely,

Larry Etchechury
Director

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